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Supreme Court of the United States

OCTOBER TERM, 1946.

No. 850.

HARRISON WILLIAMS, CLIFFORD F. STONE, SIDNEY J. WEINBERG, WADDILL CATCHINGS, JOHN FOSTER DULLES, WALTER E. SACHS, HENRY S. BOWERS, CLINTON M. FINNEY, JAMES F. FOGARTY, HERBERT C. FREEMAN, JOHN B. NIVEN, HENRY E. MENDES, FRANCIS J. CLOWES, VICTOR H. STEMPF, EDWIN H. WAGNER, SR., ROBERT C. BROWN, WILLIAM C. BECHERT, JACOB P. FRIEDMAN, ALBERT E. PARDEE, RALPH JONAS, LOUIS E. KILMARX, CHRISTIAN A. JOHNSON, DAVID G. McCORNACK, JOHN H. ECCLES, CLARENCE F. DILLON, OTTO A. PHILIPP and HUGH B. BAKER,

Petitioners,

—against—

CARL J. AUSTRIAN and ROBERT G. BUTCHER, as Trustees of Central States Electric Corporation,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

CARL J. AUSTRIAN,
Attorney for Respondents.

ROBERT G. BUTCHER,
SAUL J. LANCE,
GEORGE H. SCHWARTZ,
ISADORE H. COHEN,
Of Counsel.

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Petitioners,

—against—

CARL J. AUSTRIAN and ROBERT G. BUTCHER, as Trustees of Central States Electric Corporation,
Respondents.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

Question Presented.

The sole question involved is whether a Chapter X trustee, having discovered in the course of his investigations pursuant to section 167 of the Bankruptcy Act causes of action against the management of a debtor and affiliated interests, and having been specifically authorized by the Bankruptcy Court to bring suit thereon in a district court of the United States other than that in which the petition for reorganization was filed and the reorganization is pending, may bring such a plenary

suit in that other district regardless of whether there is diversity of citizenship.

The court below found jurisdiction in section 2 of the Bankruptcy Act (section 23 having been made inapplicable by section 102) and therefore did not consider the other grounds of jurisdiction urged by respondents.

Statement.

It is respondents' position that, apart from its interlocutory character,[1] the decision of the court below does not warrant further review because it is clearly correct and not contrary to decisions of this Court[2] or of other circuits.[3]

Respondents are the Trustees of Central States Electric Corporation[4] appointed by the United States District Court for the Eastern District of Virginia in Chapter X proceedings now pending in that Court. These Trustees were appointed after the decision of the Fourth Circuit Court of Appeals in the *Matter of Central States Electric*

[1] The fact that the decision below is interlocutory is of itself sufficient basis for the denial of the writ. If the district court had found jurisdiction that decision, right or wrong, would not have been reviewable until final judgment. The mere fact that the decision sustaining jurisdiction was made by the court below should not operate to allow piecemeal review which would otherwise not have been permissible.

[2] *Lathrop* v. *Drake*, 91 U. S. 516 (1875); *Babbitt* v. *Dutcher*, 216 U. S. 102 (1910); see *Bardes* v. *Hawarden Bank*, 178 U. S. 524 (1900), and *Schumacher* v. *Beeler*, 293 U. S. 367 (1934).

[3] Petitioners do not claim that there are conflicting decisions in other circuits. They merely guess that there may be such conflicts in the future. That is no basis for the granting of a writ in this case.

[4] Hereinafter variously referred to as "Central States" or as the "Debtor".

Corporation, 143 F. 2d 684 (1944). That Court stated at page 686:

> "The great losses sustained by the corporation, the gross mismanagement shown, the clear abuse of power by corporate officers in contracts made for and with the corporation, the recommendation of the governmental agency charged with the supervision of matters of this sort,—all of these called for an investigation of the most complete and thorough-going character, with opportunity to examine under oath those who had knowledge of the corporation's affairs and with institution of suits for recovery, where probable liability had been shown, to the end that all of the processes of discovery provided by law might be fully used. * * *"

Pursuant to that direction, respondents, as Trustees of Central States, conducted an investigation under section 167 of the Bankruptcy Act into the acts and conduct of the former management of Central States. That investigation disclosed facts indicating that petitioners—the defendants in this action—as officers, directors, and controlling stockholder of Central States, together with other conspiring parties, had wrongfully abused the Debtor and had engaged in shocking conduct against the investing public. Upon discovery of these facts, the United States District Court for the Eastern District of Virginia authorized and directed that the Trustees-respondents institute this action in the Southern District of New York.

The complaint alleges that petitioners conspired to waste, destroy, misappropriate and otherwise improperly deal with the property and assets of the Debtor and that petitioners were guilty of breaches of trust and waste of assets. Respondents seek an accounting for

the asset losses and profits involved in these transactions and claim damages of upwards of $39,000,000, exclusive of interest.

The district court granted the motion of respondents to dismiss the complaint upon the ground that the court lacked jurisdiction of the subject matter of the action. The court below reversed and sustained the jurisdiction.

The question thus presented to this Court is whether a Chapter X trustee, in carrying out the duties and functions of his office under the federal statute governing corporate reorganizations, may bring a plenary action against adverse claimants to recover assets of the estate in a district court other than the one in which the reorganization proceeding is pending, regardless of diversity of citizenship.

This is precisely the kind of case which Congress envisaged when it enacted Chapter X and granted jurisdiction to the district courts of such suits.[5] As the Securities and Exchange Commission stated in its brief in

[5] Petitioners' arguments that the decision below would open the federal courts to a flood of "$20 claims" is not persuasive. Certainly, the present suit involves a larger amount ($39,000,000). And it clearly is the exact Chapter X suit arising out of a Chapter X investigation by a Chapter X trustee which Congress had in mind in sections 167 and 102. Nor are we impressed with the fear that Chapter X trustees will burden the federal courts with ordinary claims of $20—or less. We may assume, despite the dire consequences forecast by petitioners, that the district judges will control their trustees as to choice of forum and make appropriate directions for suit in state courts on ordinary claims. Our case is of the same *genre* as those fraudulent preferences and conveyances involved in sections 60, 67 and 70, of which the district courts have jurisdiction in actions by all trustees. We are not aware that this grant of jurisdiction has resulted in any abuse, or "flood" of suits, despite the fact that Congress has not limited the jurisdiction as to the amount involved. Obviously, that trustees have not brought suits to set aside $20 transfers is due to reasons of business and administrative practicality which are valid without regard to jurisdiction. The mere right to sue in the federal courts thus does not prove that suits will be brought there—or anywhere.

the court below in support of the jurisdiction of the district court:

> "The cause of action alleged in the instant case, like the typical claim which the Chapter X trustee has a duty to investigate and prosecute, is the counterpart in large corporate affairs of the old-fashioned fraudulent-conveyance. The basic charge is that the management, affiliated with the equity interests, has enriched itself at the expense of the debtor thereby depleting the funds otherwise available for creditors and other public security holders."[6]

Argument.

1. Petitioners seek to convey the impression that the claims are stale,[7] and that the decision below is novel and constitutes a far-reaching innovation in the law of federal jurisdiction. There is nothing novel about this situation. The fact is that Congress, as a reference to the legislative history of the enactment of Chapter X shows, was very much concerned with precisely this sort of litigation arising out of wrong-doings and inequities perpetrated upon a corporation by its management and "insiders". It was notorious, prior to the enactment of Chapter X, that in the reorganizations of corporations such kinds of wrong-doing had been glossed over and hidden by the very malefactors who, one way or another, finally controlled the reorganization proceeding itself to the ultimate end of escaping responsibility for their frauds.

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[6] See Brief for the Securities and Exchange Commission, *Amicus Curiae* (October, 1946), page 46, note 29.

[7] The district court, however, stated that in view of the allegations of fact in the complaint the question of limitations should await the trial of the action.

One of the prime purposes which motivated Congress in enacting Chapter X was to remedy this situation, provide a machinery for the ferreting out of old corporate abuses, provide for a more effective machinery for the prosecution of actions, and the redress of such wrongs. And to that end, Congress provided in Chapter X for the independent trustee with broad powers of investigation (section 167) and specifically removed (by section 102) the then existing restrictions (section 23) on the jurisdiction of actions by trustees in bankruptcy. This reference to legislative history and the purpose of the enactment of Chapter X are well stated in the opinion of the court below:

> "Chapter X was enacted largely because of the many abuses which developed in reorganizations under §77B. One of these was the retention of control over the debtor corporation during reorganization by 'insiders' who frequently sought to conceal and to prevent vigorous prosecution of possible causes of action against the debtor's former management. Report on Protective and Reorganization Committees, Pt. I, S.E.C., 1937, 865; N. Y. Leg. Doc. No. 66, 159th Sess., 1936, 22; Note, 50 Yale L.J. 1492, 1496. To combat this and other abuses the draftsmen of Chapter X strengthened the hand of the reorganization trustee by giving him access to lists of the debtor's security holders, in whosever hands they may be, §165, 11 U.S.C.A. §565, by placing upon him the duty of formulating the plan of reorganization, §169, 11 U.S.C.A. §569, and perhaps most important, by giving him broad powers of scrutiny of the conduct of the debtor's business by the debtor's former management, §167, 11 U.S.C.A. §567. In view of the Congressional purpose demonstrated by these provisions, it seems clear that in eliminating §23 from corporate

reorganizations under Chapter X, Congress intended to enlarge, rather than restrict, the trustee's choice of forum in prosecuting causes of action against former controllers of the debtor. This is the view of Professor Moore and of Mr. Gerdes. 6 Collier on Bankruptcy, 14th Ed., §3.20 (containing specific criticism of the opinion of the district court); 2 *id.*, §23.12; Moore's Bankruptcy Manual, 1939, 494; Gerdes, *Corporate Reorganizations—Changes Effected by Chapter X of the Bankruptcy Act*, 52 Harv. L. Rev. 1, 21."

2. With the removal of section 23 the grant of general jurisdiction contained in section 2 remains unimpaired. Section 2-a(7) gives the district courts general jurisdiction at law and in equity in proceedings under the Act to "* * * cause the estates of bankrupts to be collected, reduced to money and distributed and determine controversies in relation thereto except * * *" where otherwise provided in the Act.[8] This jurisdiction is as broad as that granted under the corresponding section 1 of the Bankruptcy Act of 1867 (*Babbitt* v. *Dutcher*, 216 U. S. 102, 107 (1910)). Section 1 of the Act of 1867 was a grant of general plenary jurisdiction of suits to which a trustee in bankruptcy was a party without regard to diversity or amount in controversy. This jurisdiction was held to extend to every district court and was not limited to the district court in which the petition in bankruptcy had been filed. *Lathrop* v. *Drake*, 91 U. S. 516 (1875); *Shearman* v. *Bingham*, 7 Nat. Bank. Reg. 490,

[8] That section 23 was the limitation envisaged by Congress in the "except" clause in section 2 has been many times stated by this Court. *Bryan* v. *Bernheimer*, 181 U. S. 188 (1901); *First Nat. Bank* v. *Title & Trust Co.*, 198 U. S. 280 (1905); *Whitney* v. *Wenman*, 198 U. S. 539 (1905); *Kelly* v. *Gill*, 245 U. S. 116 (1917).

Fed. Cas. No. 12762 (1872); *Goodall* v. *Tuttle*, 10 Fed. Cas. 579, W. D. Wis. (1872); *Babbitt* v. *Dutcher*, *supra*, at p. 111.

In an endeavor to escape the jurisdiction thus established, petitioners have attempted to place the jurisdiction in section 23 which they assert is the sole grant of plenary jurisdiction and deny that any plenary jurisdiction whatsoever is contained in section 2. They rely for this contention on dicta in *Bardes* v. *Bank*, 178 U. S. 524 (1900) and *Schumacher* v. *Beeler*, 293 U. S. 367 (1934). Admittedly, when section 23 exists, it affects the jurisdiction of the district courts of plenary suits brought by trustees in bankruptcy. When the question of the jurisdiction of the district courts of such suits by ordinary trustees in bankruptcy was presented to this Court in cases involving the Bankruptcy Act of 1898, it made no difference whether the jurisdiction was placed precisely in 2 or 23 or in both together, since the two sections determined the scope of jurisdiction. The *Bardes* and *Schumacher* cases, decided when the Act contained both sections 2 and 23, thus did not pass on the scope of the jurisdiction contained in 2 alone. Accordingly, any statements in those cases as to the source of jurisdiction where section 2 is alone involved, are *dicta* and not decisive of the issue—as the Court below very properly pointed out.[9] Contrary views on this point were expressed by way of *dictum* in another decision of this Court under the 1898 Act. (*Babbitt* v. *Dutcher*, *supra*, 107, 111.)

In the final analysis, it is unnecessary to decide precisely what effect section 23 actually had when it and section 2 were both in effect because section 23 was removed from

[9] This Court has itself pointed out that the *Bardes* case contains erroneous *dicta* on other matters of bankruptcy administration (*Bryan* v. *Bernheimer*, 181 U. S. 189, 197).

proceedings under Chapter X by section 102. With the removal of section 23, section 2 must be given effect according to its plain language unless a contrary Congressional intent appears. That there is no such contrary intent is made clear by the Court below as follows:

> "In view of the Congressional purpose demonstrated by these provisions, it seems clear that in eliminating section 23 from corporate reorganizations under Chapter X, Congress intended to enlarge, rather than restrict, the Trustee's choice of forum in prosecuting causes of action against former controllers of the debtor."

The argument of petitioners that section 2 is not a grant of jurisdiction of plenary suits rests entirely on the construction of the word "proceedings" in section 2. It is urged that irrespective of the context in which the term appears in the Act it applies only to the summary steps in a bankruptcy administration.[10] There is no basis for this argument which is an unwarranted attempt to define the term "proceedings" restrictively. An analysis of various portions of the Bankruptcy Act will readily show that the term "proceedings" is used interchangeably with "suit" or "action". Thus, section 11e of the Bankruptcy Act authorizes trustees to "institute proceedings in behalf of the estate upon any claim". And in another connection, the same section refers to "any proceedings,

[10] This construction leads petitioners to the fallacious contention that the decision below would deny a jury trial in all actions brought by Chapter X trustees. Obviously, the right to a jury trial will be determined in such actions by the same rules which govern any ordinary plenary suit brought in a federal court. Bankruptcy Act, Sec. 19(c), 11 U. S. C. A. 42(c); *Wm. Edwards Co.* v. *La Dow*, 230 F. 378, 381 (C. C. A. 6, 1916); *In re Russell*, 101 F. 248, 251 (C. C. A. 2, 1900); *Smith* v. *Mason*, 14 Wall. 419, 432 (1871); Cf. *Marshall* v. *Knox*, 16 Wall. 551, 556, 1872. See *Galbraith* v. *Vallely*, 256 U. S. 46, 50 (1921).

judicial or otherwise". Obviously, as the term "proceedings" is used in section 11e, it refers to and includes a suit or action.

So also sections 60b, 67e and 70e(3) of the Act, dealing with preferences and fraudulent conveyances, confer upon the district courts, and upon state courts, concurrent jurisdiction over certain "plenary proceedings". Plainly, the term "proceedings" in these sections refers to and includes suits or actions. Indeed in discussing the provisions of section 70e(3), the Congressional Committee used both terms "action" and "proceeding" interchangeably (H. Rep. 1409, 75th Cong., 1st Sess., pp. 20, 35), and the bill described the plenary actions thereunder as "proceedings" (Id., p. 96).

As a matter of fact, section 2 creating jurisdiction in "proceedings" also provides in subdivision 7 for the determination of "controversies" in relation to the collection of the estates of bankrupts. That "controversies" in this context includes plenary suits is clear from the fact that the same term is used in section 23—which petitioners concede deals with plenary suits.

Finally, a consideration of section 102 shows the fallacy of petitioners' argument. Section 102 incorporates Chapters I to VII in reorganization "proceedings". If "proceedings" in section 2 is limited entirely to the summary steps in the administration of a reorganization, then it follows that a Chapter X trustee has no power to institute a suit or an action. However, by virtue of section 102, it is clearly contemplated that a Chapter X trustee will institute suits or actions to set aside preferences and fraudulent transfers as provided in sections 60, 67 and 70 of the Act. Indeed, section 60 (in subdivision a) and section 67 (in subdivisions a(1), a(2), b, c, d(2) and d(3)) directly and by express wording refer to actions by a Chapter X trustee to avoid such fraudu-

lent preferences and transfers. Moreover, if a Chapter X proceeding involved only an administration and not the bringing of actions by a trustee there would have been no point in specifically excluding section 23 (which clearly deals with actions) from reorganization proceedings under Chapter X.

This analysis of the various portions of the Bankruptcy Act dealt with above shows that there is no basis for the argument of petitioners that the term "proceedings" must be given a restrictive meaning. On the contrary, the congressional intent is clear that the term "proceedings" includes suits or actions.

CONCLUSION.

The decision of the court below is clearly correct and no questions are presented which warrant consideration by this Court. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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